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**¶1.** (U) This cable contains the Japan Economic Scope from August 16, 2007.

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FINANCE AND FISCAL POLICY  
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**¶13.** (U) Tokyo Markets Respond to Global Turmoil  
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Tokyo's equity and foreign exchange markets reacted sharply to the subprime-generated turmoil in U.S. and European markets this week.

The Nikkei 225 stock market index fell nearly six percent in the week ending August 16, and is down more than 11.5 percent since its recent high on July 9. The benchmark 10-year Japanese government bond yield fell to 1.66 percent on August 16 from 1.78 percent a week earlier, as expectations for a rate hike by the Bank of Japan next week dissipated.

The yen strengthened against most currencies, as carry trades unwound, strengthening 2.6 percent against the U.S. dollar and 5.1 percent against the Euro over the week.

Nonetheless, short-term credit markets in Japan remained calm, largely unaffected by the liquidity concerns affecting U.S. and

¶4. (U) Limited Subprime Impact on Japanese Financial Institutions

All indications point to quite limited exposure of Japanese financial institutions to U.S. subprime loans and securitized products. Banks are likely the most exposed and a recent investment bank report analyzes that a negative impact on the creditworthiness of major Japanese banks is not expected. Without the benefit of any hard data, the limited exposure of Japanese financial institutions points to a low likelihood of a significant exposure by Japanese retail investors. (FINATT: Maureen Grewe)

¶5. (U) Carry-Trade Unwind: More Bark than Bite

Fears that the unwinding of the yen carry-trade would be calamitous for financial markets appear to be excessive, according to Tokyo-based financial sector analysts.

Reports that net non-commercial short-yen positions on the Chicago Mercantile Exchange have fallen by 80 percent since June as part of a broader unwind of short-yen positions and accompanying moderation in the yen's value appear to show that the absolute size of those positions is not enough to have a significant impact on the exchange rate when they are closed. One explanation cited is the probability that capital outflows from Japan is deeper than the array of speculative futures positions, and as a result are not overly responsive to those positions' unwinding.

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The yen carry trade phenomena had prompted fears that a significant reversal in speculative short-yen positions could prompt a sharp change in exchange rates, causing financial system distress, as in 1998 when the yen rose from ¥137/US\$ in late September to ¥115 by mid-October; in this instance the exchange rate has risen by around five percent, which is not a significant change in macroeconomic terms. (FINATT: Mateo Ayala)

¶6. (U) Japan: Second Quarter Real GDP Grew Weaker-Than-Expected 0.5 percent

Japan's real GDP grew at a 0.5 percent annualized rate in Q2 2007, after a sizable increase in each of the previous two quarters, according to the preliminary data announced by the Cabinet Office on August 13.

GDP growth in Q2 was weaker than private analysts' consensus forecast of a 0.9 percent increase. Overall real GDP growth for Q2 reflected a 0.9 percentage-point (pp) contribution from final domestic demand, supported by firm business investment and personal consumption, and another 0.2pp contribution from net exports. On the other hand, the contribution to overall growth from inventories was --0.5pp in the quarter. The overall GDP deflator dropped 0.3 percent y/y in Q2, the same rate of decline as in the previous quarter.

For the first half of 2007 as a whole, real GDP grew at a 1.8 percent annual rate, in line with Japan's estimated potential growth rate of about 1.5-2.0 percent. (FINATT: Shuya Sakurai)

¶7. (U) Japan's Cabinet Approves Restrictive Budget Request Guidelines for FY08

On August 10, the Abe Cabinet completed the first major phase of the FY08 budget formulation process by setting restrictive guidelines for budget requests from individual ministries and agencies.

The formulation of FY08 budget request guidelines is the first

major post-election test on the direction of fiscal policy for the Abe administration. Under the guidelines, "ministerial budget" spending is estimated to total approximately Y47.3 trillion, up about Y0.3 trillion, or 0.7 percent, compared to the present FY07 budget.

Ministerial budget spending has been almost unchanged at roughly the Y47 trillion level since FY02. If social security spending is excluded, the remaining ministerial budget spending has fallen by Y4.0 trillion, or 13.2 percent, from FY02. Social security spending has increased Y3.7 trillion, or 21.6 percent, from FY02, due largely to demographic factors.

The guidelines demonstrate the Abe Administration's continuing commitment to fiscal consolidation and its intention to place top priority on curbing discretionary government spending to achieve that consolidation. (FINATT: Shuya Sakurai)

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AROUND THE REGIONS  
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18. (SBU) Sharp Makes Its Presence Felt in Osaka

Sharp's decision to build a new plant in Sakai City is already producing palpable benefits in Osaka Prefecture. Since Sharp's announcement in May, Osaka Prefecture government officials have received numerous inquiries about government-owned properties in Sakai. These same properties attracted almost no interest prior to May. Government officials have decided to sell the sites through a bidding process.

The new LCD production facility in Sakai will be almost four times as big as Sharp's LCD plant in Kameyama city of Mie Prefecture and many local businesses in Sakai and the Kansai are vying to offer their services to Sharp.

To maximize potential benefits, some companies are studying how businesses that relocated to areas nearby Sharp's LCD plant in Kameyama City were successful. The new LCD plant is predicted to

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inject more than one trillion yen into Sakai's economy. The Chairman of Sharp, Katsuhiko Machida, announced this week that he would be appointed as the Vice Chairmen for the Osaka Chamber of Commerce and Industry (OCCI). Previously, Sharp had refused offers to join local economic organizations, preferring to concentrate its attention on internal business matters.

In contrast, Sharp's competitor in the digital appliance industry, Matsushita, has been active in local business activities in the Kansai. With annual sales eclipsing 3 trillion yen this past year, Chairman Machida stated it is imperative for Sharp to join OCCI and carry out its corporate social responsibilities (and of course compete with Matsushita). (Osaka-Kobe: Phil Cummings/Scott Ravenhill/Naomi Shibui)

19. (SBU) Corning and Sharp to Be Neighbors in Sakai

According to Osaka government officials, Corning Japan K.K., a subsidiary company of Corning Incorporated based in New York (<http://www.corning.com/>), will open a plant near the site of Sharp's new LCD Plant in Sakai City. Corning is one of the leaders in producing glass components used in LCD flat panel televisions. The investment amount is estimated to be around 100 billion yen.

Organizers of the U.S. -- Japan Investment Initiative Seminar being held in Osaka on September 12-13 had sought to get an executive from Corning to speak at the seminar, but were unsuccessful. (Osaka-Kobe: Phil Cummings/Scott Ravenhill/Naomi Shibui)

¶10. (U) Diet Reviews Fundamental Space Law

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The Japanese Diet is currently considering a "Fundamental Space Law" that would change Japan's policies on space development and use. The legislation emphasizes a need for enhanced domestic aerospace sector competitiveness; more autonomous Japanese aerospace capabilities; stronger ties between industry, the government, and academy (San-Kan-Gaku); and potential use of space for defensive purposes.

The legislation calls for these priorities to be incorporated in a new Japanese national space plan that would be coordinated and managed by a new "Space Minister" and associated staff within the Cabinet Office. The legislation also calls for a review of the 2003 law that established the Japan Aerospace Exploration Agency (JAXA).

The 1969 and 2003 laws that established Japan's space program strictly limit Japan's use of space for peaceful purposes. Consequently, the domestic defense aerospace sector has been somewhat limited in size and capability. The Fundamental Space Law appears to be driven in part by this sector seeking a larger role in the defense aerospace market. The perception of increased regional threats from North Korea and China also appear to be a factor.

Prior to the July 2007 Upper House election in which the opposition Democratic Party of Japan gained the Upper House majority, the Fundamental Space Law was expected to be passed by the Diet in the Fall session. While still likely to be passed, the schedule is now unclear. (NASA: Justin Tilman)

¶11. (U) Japan boasts Globe's Best Public Transport, 8 Million People Ride Tokyo Metro Daily

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Tokyo Metro subway officials detailed security improvements to counter attacks or natural disasters, the final phase of Tokyo Metro privatization and their strong financial balance sheet in a meeting at their offices on August 10.

They highlighted the extraordinary percentage of Tokyo commuters using the subway/rail system, noting the positive impact of public transportation on the environment. They detailed their technical assistance to Asia, Africa, Latin America and the

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Middle East.

The subway officials were proud to tell us that they move a million passengers during the one hour of morning commute alone, eight million a day and nearly 3 billion a year over 880 kilometers of rail.

Compared to New York City's less than 400 kilometers of rail, it is more than twice as large and moves twice the volume of passengers. Some 75 percent of all people and products moved in Tokyo are transported using a combination of subway and railway lines.

Tokyo towers over other large metro systems, carrying about as many passengers as the rail systems in London and New York combined. (ECON: Charlie Crouch)

¶12. (U) MLIT Takes Steps Toward Sky Highway

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The Ministry of Land, Infrastructure and Transport (MLIT) announced on August 13 that a new system called RNAV for air traffic will be introduced on 75 domestic routes by the end of ¶2012.

The effort is part of the Sky Highway Plan which would allow more efficient flight plans, enabling reduced flight times, more aircraft to fly and CO<sub>2</sub> reductions.

RNAV will be implemented starting this fall at eight airports including Haneda and Kansai International Airport along with other regional airports. (ECON: Junko Nagahama)

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TELECOMMUNICATIONS AND IPR  
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¶13. (U) End to Cost-Sharing Regime for NTT Fixed-Line Service

Nikkei reported on August 11 that MIC plans to abolish in 2009 the cost-sharing framework designed to provide universal fixed-line phone service throughout Japan.

Nippon Telegraph and Telephone (NTT), through its two regional units, have historically been required to offer fixed-line phone service across Japan, including to rural areas and remote islands.

To compensate NTT for operating losses in remote areas, the government introduced in 2002 a framework under which other telecommunications service providers would share the costs. NTT's fixed-line losses have continued to widen, however, as consumers are increasingly using mobile phones. As a result, wireless service providers, KDDI, Softbank, NTT DoCoMo, and other carriers have started passing on their share of the costs to consumers in the form of a seven yen per month per phone line charge.

Consumer groups have complained about consumers having to bear the costs of universal service, pressing for NTT to continue to seek efficiency gains and bring down prices.

As carriers extend the reach of cable and fiber-optic networks, and the government has set a goal of a nation-wide high-speed optical network by 2010, it is expected that the government will encourage other options to fixed-line telephony in order to help assure universal service. (ECON: Scott Smith/Kaoru Nakata)

¶14. (U) Telecommunications Accounting System Report --Public Comment Announcement

MIC announced a public comment period, until 10 September, on a report entitled 'Accounting System for Telecommunications Businesses'.

The report's chapters include:

    Need for Review of the Accounting System  
    Facility Categorizations in Interconnection Accounting  
    Service Categorizations in Telecommunications Business  
    Accounting  
    Cost Allocation  
    Depreciation Costs

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Transparency in Transactions with Subsidiaries  
Increased Feasibility of an Accounting System Review  
Development of Measures

Annex: British Telecommunications Accounting System (ECON:  
Scott Smith/Kaoru Nakata)

¶15. (U) Intellectual Property in Japan

Econ and FCS officers, and a British Embassy colleague, participated in an informal IPR seminar offered pro bono by a local law firm. Lawyers from the firm Yamasaki & Partners presented on basic procedures and the legal framework covering patents, trademarks, and copyrights in Japan. The firm, apparently hoping to attract future business with foreign firms, has reportedly provided the seminar for numerous other embassy

colleagues over the past year.

At this time, we would simply note some potentially interesting future topics that were identified in the accompanying discussion, including: evolution of the IP and innovation environment in Japan since the 2002 passage of a new IP Fundamental Law, the development of new copyright protection technologies, and the establishment in recent years of new private sector associations to advocate IP interests in Japan. (ECON: Scott Smith/Kaoru Nakata and FCS: Dean Matlack)

¶16. (U) U.S.-Japan Cyber-Security Bilateral Talks, 28-29 August

DHS A/S Greg Garcia will lead a public-private sector U.S. delegation for U.S.-Japan bilateral talks on Cyber-Security on 28-29 August. The agenda will cover developments in information security, threats and vulnerabilities, critical infrastructure and cross-sector interdependencies, and areas for prospective future cooperation.

Both in the U.S. and Japan, structures and institutions to assure cyber-security, protect critical infrastructure and respond to incidents are relatively new. The National Information Security Center (NISC) is Japan's coordinating agency for information security and was founded only in 2005, partly as a result of U.S.-Japan Cyber-Security talks in Tokyo in 2003. DHS has indicated that it would like to see tangible outcomes result from these talks, and one expected result is to lay the groundwork for further future cooperation. (ECON: Scott Smith/Kaoru Nakata)

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SPORTS  
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¶16. (U) Fighting to be NFL's first Japanese player, Kinoshita says It's Tough

His smile disappeared on day one. After practice Kinoshita muttered, "It's tough." His first NFL camp demands more than he expected.

For 30 minutes at the end of practice, wide receivers took turns, but Kinoshita got only three shots: precious little chance to impress the coach.

With three years NFL Europe experience, he should be well prepared. Yet Kinoshita felt as if he had stepped into a different dimension. The playbook, handed out the day before camp started, is so packed that is hard for native English speakers to memorize. The WR coach, Petrino, sympathized with Kinoshita. "It must have been tough to learn everything on the first day," he said.

Cut from 90, the final 53 players for the roster will be announced on September 1, and the WR position will only have five or six players. Kinoshita's challenge to become the first Japanese NFL player has just begun. (Summary translation by FCS: John Fleming)

¶17. (U) This SENSITIVE BUT UNCLASSIFIED e-newsletter from U.S. Embassy Tokyo's Economic Section, with contributions from the consulates, is for internal USG use only. Please do not forward in whole or in part outside of the government. The Scope is

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¶18. (U) Please visit the Tokyo Econ Intranet webpage for back issues of the Scope. Apologies, this option is only available to State users. Please contact Joy Progar if you are from a different agency and are interested in a back issue.